

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF IDAHO

IN RE)	
)	Case No. 99-40343
KIP G. and CHERI LYN)	
MICKELSEN,)	
)	
Debtors.)	
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)	
AGRICREDIT ACCEPTANCE)	
LLC, dba Agricredit Acceptance)	Adv. No. 00-6033
Company,)	
)	
Plaintiff,)	MEMORANDUM OF DECISION
)	RE PLAINTIFF'S MOTION FOR
)	SUMMARY JUDGMENT
vs.)	
)	
U.A.P. NORTHWEST, a foreign)	
corporation; KIP G. and CHERI)	
LYN MICKELSEN, husband and)	
wife, and DOES 1-20,)	
)	
Defendants.)	
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Randal J. French, BAUER & FRENCH, Boise, Idaho, for Plaintiff.

Daniel C. Green, RACINE OLSON NYE BUDGE & BAILEY,
Pocatello, Idaho, for Defendant U.A.P. NORTHWEST

Bart M. Davis, Idaho Falls, Idaho, for Defendants Mickelsen.

Background

Plaintiff Agricredit Acceptance LLC, an entity doing business in Idaho as Agricredit Acceptance Company (“AAC”), and Defendant UAP Northwest (“UAP”) extended credit to Chapter 12 Debtors Kip and Cheryl Mickelsen. In this adversary proceeding, AAC seeks to enforce the terms of a subordination agreement entered into with UAP in 1998. The particular provision at issue provides that AAC will receive payment in full of its claims against Debtors before UAP receives any payment on its accounts with the Debtors. AAC filed a motion for summary judgment on April 28, 2000 and a hearing was held on the motion on May 31, after which the matter was taken under advisement.

Facts

The following facts appear undisputed from the record.

Debtors entered into several credit transactions with UAP in 1997 and 1998. On August 7, 1997, they signed a promissory note for \$118,540.07 and a line of credit and security agreement in the amount of \$162,571.80. On September 25, 1998, they executed another line of credit and security agreement in the amount of \$240,000. The Debtors’ obligations to UAP were

secured by a security interest in Debtors' crops, equipment, inventory, and government program payments. To perfect its security interests, UAP filed appropriate financing statements with the Idaho Secretary of State.

In 1998, AAC also provided agricultural financing to Debtors. The credit advanced by AAC to Debtors was represented by Debtors' promissory note in the maximum principal amount of \$385,000 dated April 2, 1998. The credit was secured by a security interest in Debtors' crops, program payments and equipment. However, as a condition of this transaction, AAC required UAP to subordinate its secured interest in the collateral held by UAP to secure its claims against Debtors. UAP and AAC executed a written subordination agreement dated April 20, 1998.

Debtors filed their Chapter 12 petition on March 10, 1999. According to AAC, Debtors owe AAC approximately \$165,000. According to UAP, Debtors owe UAP about \$600,000. On December 13, 1999, this Court entered its order (Docket No. 71) confirming Debtors' Amended Chapter 12 Plan (Docket No. 59). The confirmed plan provided for full payment of AAC's claim with interest in five annual installments to be made by the Chapter 12 trustee beginning May 1, 2000. The plan provided UAP was to receive about \$102,000 plus interest as a secured creditor, representing the value of Debtors' 1998 crop

proceeds not used to operate Debtors' business, and also representing government program payments. UAP's secured claim was also to be paid in five annual installments by the Chapter 12 trustee beginning May 1, 2000. The balance of UAP's claim was treated as an unsecured claim under Debtors' plan. Unsecured creditors will not be paid in full, but instead will share pro-rata in an additional modest annual installment to be paid through the Chapter 12 trustee.

The Court's order confirming Debtors' plan contained several provisions resulting from the negotiation of the interested parties, including AAC and UAP. One such provision states, in pertinent part, that:

The confirmation of the Amended Chapter 12 Plan and this confirmation order does not change or determine the relative lien priorities between Agrico Credit Acceptance LLC, J.R. Simplot, and UAP Northwest. Agrico Credit may seek a separate determination of lien priorities by adversary action, or seek participation [in] any adversary action as provided in Article IV, Class Six, paragraph (c) of the Amended Plan.

Order Confirming Chapter 12 Plan, p. 2.¹ In other words, under this provision of the order, confirmation of Debtors' plan did not constitute a determination of the respective lien priorities held by AAC and UAP in Debtors' assets. Instead, the

¹ The plan provisions referenced in the order allow UAP to prosecute an adversary proceeding against J.R. Simplot Company, another creditor claiming a lien in Debtors' assets. This paragraph of the plan does not specifically mention AAC.

Order allowed AAC, if it chose to do so, to obtain a judicial determination of its lien priorities in a separate adversary proceeding to be filed some time after confirmation.²

On January 19, 2000, AAC filed this adversary proceeding. AAC seeks a judgment ordering the Chapter 12 trustee to make any payments otherwise intended by Debtors' plan for UAP to be made to AAC until its claim is paid in full.³

Issue

The outcome of this action involves one sentence in the 1998 AAC-UAP subordination agreement. It provides "Creditor [i.e., UAP] agrees that AAC shall be paid in full before Creditor is entitled to receive payment from Debtor from any source." Plaintiff's Complaint, Exhibit K: Landlord/Creditor Subordination Agreement, p. 1. AAC contends the subordination agreement

² Consistent with a practice generally followed by the Court in Chapter 12 cases, given the importance of the terms of a confirmation order, counsel for Debtors, AAC and UAP and other parties were required by the Court to approve the language of the order prior to its entry. Counsel did so by endorsing their signatures on the form of order.

³ AAC's complaint also names the Chapter 12 Debtors as defendants. However, the Court cannot tell from a reading of the complaint whether AAC has requested any relief against Debtors.

dictates that it receive payment in full before UAP receives any payment on its claims, including any payments provided by Debtors' confirmed plan. Therefore, AAC requests an order requiring the Chapter 12 trustee to disburse all payments, otherwise to be made under the plan to UAP, to AAC until its claims are paid in full.

UAP objects and argues that confirmation of Debtors' Chapter 12 plan effectively altered the operation of the AAC-UAP prebankruptcy subordination agreement. In the alternative, and even if the subordination remains enforceable, UAP asserts AAC should be estopped from enforcing the agreement's terms because of its conduct during the Chapter 12 case.

Applicable Law

Summary judgment is only appropriate if, after viewing the evidence in the light most favorable to the non-moving party, there are no genuine issues of material fact remaining and the moving party is entitled to judgment as a matter of law. Fed. R. Civ. P. 56; Fed. R. Bankr. P. 7056; *Anguiano v. Allstate Insurance Company*, 209 F.3d 1167, 1169 (9th Cir. 2000); *Newman v. American Airlines, Inc.*, 176 F.3d 1128, 1130 (9th Cir. 1999).

Discussion

The Bankruptcy Code provides that “[a] subordination agreement is enforceable . . . to the same extent that such agreement is enforceable under applicable nonbankruptcy law.” 11 U.S.C. § 510(a). Under Iowa Code Section 554.9316, the priority of a security interest may be varied or modified by the terms of a subordination agreement.⁴ Here, UAP concedes its security interests in Debtors’ assets are subordinated to the claims of AAC to the extent provided by the subordination agreement. Debtors’ Amended Chapter 12 plan effectively incorporates these priorities, the effect of which is that AAC is recognized as having a prior security interest in Debtors’ assets securing both AAC’s and UAP’s claims. As a result, under the plan, AAC will be paid in full, while UAP will receive only partial payment as a secured and unsecured claimant. See 11 U.S.C. § 506(a) (determination of secured status for bankruptcy law purposes); and 11 U.S.C. § 1225(a)(5) (standard for treatment of secured claims in a Chapter 12 plan).

⁴ The subordination agreement dictates the law of Iowa be applied to resolve any issues concerning the contract. Neither party raises concerns about whether Idaho or Iowa law should apply because, they assert, in this case, applicable legal rules do not vary significantly between the two jurisdictions. Because neither party contends that the subordination agreement is not authorized nor enforceable under applicable nonbankruptcy law, the Court need not reach any choice of law issue. As a result, the interpretation of the subordination agreement is analyzed under Iowa law, because that is the choice of law dictated by the parties.

However, the precise issue to resolve here does not focus on the relative lien priorities of the parties in Debtors' property. Instead, that issue involves whether, as provided in the subordination agreement, AAC is entitled to payment in full before UAP may receive any payment under Debtors' plan. Put differently, the question for the Court is whether the subordination payment scheme was modified by the terms of Debtors' Amended Chapter 12 plan and the Court's order confirming the plan.

It is fundamental that the provisions of a confirmed Chapter 12 plan bind the debtors and all their creditors. 11 U.S.C. § 1227(a); *Arkison v. Plata (In re Plata)*, 958 F.2d 918, 921 (9th Cir. 1991). The policy implemented in Section 1227(a) provides critical finality to the confirmation order in determining the rights and duties of all interested parties to the Chapter 12 case in order to allow the debtor to reorganize its financial affairs. See *Sealey Brothers v. Farmers Home Administration (In re Sealey Brothers)*, 158 B.R. 801, 805 (Bankr. W.D. Mo. 1993). Following confirmation, the Chapter 12 trustee is obligated by law to distribute payments in accordance with the confirmed plan. 11 U.S.C. § 1226(a). In the traditional sense, entry of a confirmation order has a res judicata effect on all matters dealt with in the plan or issues that were decided, or could have been

decided, at confirmation. *In re Perry*, 91 I.B.C.R. 184, 186 (Bankr. D. Idaho 1991).

The confirmed Chapter 12 plan in this case provides for full payment of AAC's claim, and partial payment of the claims of UAP, in five annual installments beginning May 1, 2000. In this regard, the plan is consistent with the provisions of the AAC-UAP subordination agreement. However, Debtors' plan makes no express provision for full payment to AAC before the Chapter 12 trustee may distribute any money to UAP. Debtors' plan is, at best, silent respecting the status of AAC's rights under the subordination agreement. At worst, the plan runs contrary to the terms of the agreement.

Frequently, as a result of negotiations between parties in connection with Chapter 12 cases, provisions modifying the terms of a Chapter 12 plan will be incorporated in the Court's order confirming the plan. That occurred in this case.⁵ The confirmation order provides that the "order does not change or determine the relative lien priorities between Agricredit Acceptance LLC, . . . and UAP Northwest." Order Confirming Amended Chapter 12 Plan

⁵ 11 U.S.C. § 1223 allows the Chapter 12 debtor to modify the proposed plan at any time before confirmation. A plan may be confirmed if the provisions relating to the treatment of a secured creditor, such as AAC and UAP, have been accepted by the creditor. 11 U.S.C. § 1225(a)(5)(A). By consent of Debtors' and creditors' counsel to the terms of the order confirming plan submitted to the Court for entry, Debtors' plan was modified, and the creditors accepted the modification, as set forth in the order.

and Granting Related Motions, p. 2 (Docket No. 71). The order then explains that AAC may, through an adversary proceeding, seek resolution of any lien priority issues. A reasonable interpretation of this provision of the order would allow AAC to rely upon the adjustment of priorities agreed to by AAC and UAP before the bankruptcy case was filed, and to seek judicial enforcement of its lien priorities contained in the subordination agreement, if necessary.

Neither the order nor the plan specifically articulate that AAC may, after confirmation, seek enforcement of other rights bestowed by the subordination agreement in a separate adversary proceeding. However, neither the order nor the plan specifically prohibit such an action either. Moreover, AAC reminds the Court that it raised its concerns about its right to prior payment in its objection to confirmation of Debtors Amended Chapter 12 plan. See Objection to Confirmation, filed September 17, 1999 (Docket No. 67), p. 2.⁶

A Chapter 12 plan may modify the contractual rights of the debtors' creditors. 11 U.S.C. § 1222(b)(2). A Chapter 12 plan modifying the rights of secured creditors may be confirmed if the plan has been accepted by the

⁶ AAC's objection reads in part that "[b]y virtue of [a] Subordination Agreement, UAP Northwest agreed that 'AAC shall be paid in full before UAP Northwest is entitled to receive payment from Debtor from any source.' Debtors by their Chapter 12 plan, seek to alter this contractual arrangement between UAP Northwest and AAC. AAC does not consent to this alteration of the right to be paid in full before UAP Northwest receives any payment."

affected creditor. 11 U.S.C. § 1225(a)(5)(A). Debtors' plan provides for payment in full of AAC's and UAP's allowed secured claims over the life of the plan and provides that AAC and UAP will retain their respective prebankruptcy liens in the Debtors' property to secure payment of the creditors' allowed secured claims. The plan specifies that both AAC and UAP will receive annual payments on account of their claims from the Chapter 12 trustee. The affected creditors, AAC and UAP, accepted the plan provisions. The plan was therefore properly confirmed.

The Court respectfully declines AAC's invitation to read additional provisions into the plan or order confirming the plan. To enforce the subject sentence in the subordination agreement, providing that AAC will receive full payment before UAP, judicially modifies the operation of the plan and treatment of creditors claims, the effect of which is now binding on AAC. To require all payments designated for UAP under the plan be redirected to AAC would compromise the plan's compliance with Section 1225(a), unless UAP were to accept such treatment. Assuming AAC had an enforceable right to payment in full in preference to UAP, such was a right which should have been expressly preserved in the plan or order. *See Kelley v. South Bay Bank (In re Kelley)*, 199 B.R. 698, 704 (9th Cir. B.A.P. 1996) (confirmed plan must expressly reserve the

right to litigate a specific cause of action postconfirmation; general reservations are not sufficient to preclude application of res judicata). It is not a matter properly raised post-confirmation.

The Court also concludes that enforcing AAC's right to full payment under these circumstances may undermine not only the express provisions of the Code, but also the inherent policy concerning the treatment of creditors under Chapter 12. When federal bankruptcy law clearly dictates a purpose or policy, that law may displace otherwise applicable state law. *BFP v. Resolution Trust Corporation*, 511 U.S. 531, 544-45 (1994). The Code is clear that a Chapter 12 plan may modify a creditor's rights, and that confirmation of that plan is a binding, res judicata judicial determination.

AAC argues that disregarding the provision of the subordination agreement at issue would increase the risk to any lender extending credit in conjunction with a subordination agreement. The Court disagrees. The Court's decision merely highlights the importance of clearly expressing or preserving any special rights to be afforded creditors in the terms of a Chapter 12 plan. If a proposed plan fails to recognize important creditor rights, the creditor should object to confirmation of the plan and should not consent to confirmation unless the plan is modified to accommodate the creditor's concerns. In this context,

AAC's objection to confirmation, in part based upon its alleged right to payment in full ahead of UAP, merely evidences its awareness that the plan, as then written, failed to preserve the subject provision of the subordination agreement. AAC's acceptance of the plan after having asserted the objection suggests it appreciated its payment rights were to be modified. Had AAC withheld its acceptance of Debtors' plan, any dispute over its alleged right to payment in preference to UAP would have been resolved in connection with confirmation of Debtors' plan. Because the issue could have been raised, but was not, AAC is now bound by the plan.

Conclusion

In sum, AAC is bound by the payment terms of Debtors' plan which provides for payments to both AAC and UAP. The provision in the subordination agreement providing otherwise, while enforceable in a bankruptcy case, was subject to modification by Debtors' plan. AAC's rights may not be asserted now, since to do so would undermine finality of the order confirming the plan, modify the rights of other parties under the plan, and run afoul of important policies implemented through Chapter 12.

There are no genuine issues of material fact to be tried by this Court. Under the undisputed facts, as a matter of law, the sentence at issue in the subordination agreement is unenforceable. AAC's motion for summary judgment should be denied. In addition, since it appears that AAC may not be afforded relief as a matter of law, the Court concludes summary judgment should be granted in favor of UAP and this action should be dismissed.⁷ A separate order and judgment will be entered.

DATED This _____ day of July, 2000.

JIM D. PAPPAS
CHIEF U.S. BANKRUPTCY JUDGE

⁷ See, e.g., *Buckingham v. United States*, 998 F.2d 735, 742 (9th Cir. 1993) (holding that *sua sponte* summary judgment is proper when no dispute of material fact exists, and the losing party has had an adequate opportunity to address the issues involved, including adequate time to develop any facts necessary to oppose the judgment).

CERTIFICATE OF MAILING

I, the undersigned, hereby certify that I mailed a true copy of the document to which this certificate is attached, to the following named person(s) at the following address(es), on the date shown below:

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CAMERON S. BURKE, CLERK
U.S. BANKRUPTCY COURT

DATED:

By _____
Deputy Clerk

